

Message Text

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P 301544Z AUG 74

FM AMEMBASSY PARIS

TO SECSTATE WASHDC PRIORITY 1918

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FOR TREASURY FOR WIDMAN FROM MCGREW

E.O. 11652: N/A

TAGS: ECON, FR

SUBJECT: FRENCH ECONOMIC OUTLOOK OVER NEXT YEAR OR SO

1. THIS MESSAGE CONTAINS OUR CURRENT ASSESSMENT OF FRENCH ECONOMIC PROSPECTS OVER NEXT YEAR OR SO, ALONG LINES YOU REQUESTED IN OUR TELECON AUGUST 26.

2. INTRODUCTION. - AT SUMMER'S END FRENCH ECONOMY REMAINS IN GRIP OF STRONG, PERSISTENT INFLATIONARY FORCES. DURING FIRST SEVEN MONTHS OF THIS YEAR CONSUMER PRICE INDEX HAS ADVANCED AT SEASONALLY ADJUSTED ANNUAL RATE OF NEARLY 17 PERCENT. GOVT HAS JUST ANNOUNCED THAT HOURLY WAGE RATES SOARED BY MORE THAN 6 PERCENT IN SECOND QUARTER OF 1974, FOLLOWING 5 PERCENT RISE IN FIRST QUARTER. SINCE APRIL FOREIGN TRADE DEFICIT HAS AVERAGED MORE THAN 2 BILLION FRANCS PER MONTH, WITH

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SEEMING TENDENCY TO WORSEN AS YEAR ADVANCES. THESE MOST

RECENT DATA ON PERFORMANCE OF ECONOMY -- PARTICULARLY, EXCESSIVE TREND OF WAGE RATES -- SUGGEST THAT MALADY IS EVEN MORE DEEP-SEATED THAN HAD EARLIER BEEN THOUGHT HENCE THAT CORRECTION WILL BE SLOWER AND MORE PAINFUL THAN MANY HAD HOPED. DATA CONFIRM US IN OUR JUDGMENT THAT OBJECTIVES OF GOVT'S STABILIZATION PROGRAM -- CUTTING BACK PRICE RISES TO ANNUAL RATE OF 6 PERCENT BY MID-1975, HOLDING REAL WAGE INCREASES TO 2 PERCENT PER YEAR, AND RESTORING EXTERNAL EQUILIBRIUM BY END OF NEXT YEAR -- LOOK TOO AMBITIOUS FOR MEANS BEING EMPLOYED.

3. GROWTH. - WE FORESEE SLOWING OF FRENCH ECONOMIC GROWTH RATE FOR 1974, WITH THIS TREND FIRING SOMEWHAT IN FIRST PART 1975, WHEN GOVT'S STABILIZATION MEASURES WILL BE HAVING THEIR MAIN IMPACT. IN PARTICULAR, BUSINESS OUTLAYS ON PLANT AND EQUIPMENT, WHICH HAVE BEEN A MAINSTAY OF EXPANSION, SHOULD LOSE STEAM UNDER COMBINED INFLUENCE OF INCREASED TAX BURDEN ON BUSINESS AND TIGHT MONEY. HOUSING IS ALREADY SUFFERING FROM LATTER ELEMENT AND PROBABLY WILL CONTINUE TO DO SO. STRINGENT BUDGET POSITION WILL LIKEWISE DAMPEN GOVT CONSUMPTION AND INVESTMENT. ON THE OTHER HAND, RAPID EXPANSION OF MONEY WAGES AND INFLATIONARY PSYCHOLOGY SHOULD MAKE PERSONAL CONSUMPTION THE PRINCIPAL MOTOR FORCE FOR CONTINUED GROWTH. EXPANDED SOCIAL WELFARE BENEFITS TO SOME HOUSEHOLDS WILL TEND TO OFFSET RESTRICTIVE EFFECTS ON CONSUMPTION OF TAX INCREASES IMPOSED ON OTHER HOUSEHOLDS AS PART OF STABILIZATION PROGRAM. EXPORT DEMAND IS SOMETHING OF A CONUNDRUM. WHILE FRANCE MIGHT HOPE TO BENEFIT FROM SOME ECONOMIC RECOVERY IN GERMANY, GAINS HERE COULD BE LARGELY OFFSET BY THE OPPOSITE TREND ELSEWHERE-- E.G., ITALY, WHERE HIGHLY INFLATIONARY SITUATION HAS RECENTLY CREATED EASY MARKET FOR MANY FRENCH GOODS. IN SUM, WE FORESEE REAL GROWTH RATE OF ABOUT 4.8 PERCENT FOR 1974 AND 4.5 PERCENT FOR 1975. WHILE DOWN FROM THE LEVELS OF 5.5 AND 6.1 PERCENT REGISTERED IN 1972 AND 1973, RESPECTIVELY, THESE FIGURES WOULD CERTAINLY REMAIN AMONG THE HIGHEST FOR INDUSTRIAL COUNTRIES DURING THE TWO YEARS IN QUESTION.

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4. UNEMPLOYMENT. - IN JULY SEASONALLY ADJUSTED FIGURE FOR UNEMPLOYMENT WAS ABOUT 2.3 PERCENT OF LABOR FORCE, SLIGHTLY HIGHER THAN LEVEL OF ABOUT 2.2 PERCENT WHICH HAS PREVAILED OVER PAST YEAR OR SO. WHILE UNEMPLOYMENT MAY CONTINUE TO CREEP UPWARD IN MONTHS AHEAD, GROWTH RATES FORECAST ABOVE SHOULD BE SUFFICIENT TO ABSORB MOST NEW ENTRANTS INTO LABOR FORCE. ON THIS BASIS, UNEMPLOYMENT SHOULD NOT RISE SUBSTANTIALLY BEYOND 2.5 PERCENT

THROUGH END OF 1975.

5. PRICES. - IN FIRST SEVEN MONTHS OF 1974, SEASONALLY ADJUSTED CONSUMER PRICE INDEX HAS ALREADY ADVANCED BY NEARLY 10 PERCENT. THERE IS REASON TO HOPE THAT EFFECTS OF STEEP ENERGY COST INCREASES HAVE NOW BEEN MORE OR LESS ABSORBED INTO PRICE STRUCTURE. AS INDICATED ABOVE, HOWEVER, PACE OF WAGE INCREASES ACCELERATED IN SECOND QUARTER TO NEAR ALL-TIME RECORD OF 24 PERCENT AT ANNUAL RATE. IT IS, MOREOVER, HARD TO SEE HOW IN ANY NEAR TIME

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SPAN THIS RATE CAN BE BROUGHT DOWN TO A "REASONABLE" LEVEL. IT SEEMS INEVITABLE THAT WAGE BOOSTS WILL CONTINUE TO EXERT HEAVY UPWARD PRESSURE ON COSTS AND HENCE ON PRICES DURING REMAINDER OF YEAR. WE THUS ANTICIPATE THAT RISE OF CONSUMER PRICES FROM BEGINNING TO END OF

1974 WILL BE IN RANGE OF 15-16 PERCENT. WITH LUCK --
E.G., NO NEW FLARE-UP OF WORLD PRICES FOR ENERGY AND
OTHER PRIMARY PRODUCTS, SATISFACTORY PERFORMANCE OF FRANC
ON EXCHANGE MARKETS -- WORKING OF GOVT'S STABILIZATION
PROGRAM SHOULD PRODUCE SOME IMPROVEMENT IN 1975 OVER THIS
YEAR'S SORRY RECORD. BUT ABOUT THE MOST THAT CAN BE
HOPE FOR IS SOMETHING IN RANGE OF 10-12 PERCENT -- STILL
A CONSIDERABLE DISTANCE ABOVE GOVT'S PRICE TARGET, WHICH
IMPLIES RISE OF ONLY ABOUT 7.5 PERCENT FROM BEGINNING TO
END OF NEXT YEAR.

6. BALANCE OF PAYMENTS. -
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(A) WHATEVER MAY PROVE TO BE ULTIMATE EFFECTIVENESS
OF GOVT'S STABILIZATION MEASURES, THEIR INFLUENCE ON 1974
TRADE AND CURRENT ACCOUNTS WILL PROBABLY BE ONLY
MARGINAL. WE FORESEE TRADE DEFICIT THIS YEAR OF ABOUT
\$4.8 BILLION AND CURRENT ACCOUNT DEFICIT OF SOME \$6.5
BILLION. ASSUMING THAT NOTHING HAPPENS EITHER IN FRANCE
ITSELF OR ELSEWHERE TO PRECIPITATE MASSIVE FLIGHT FROM
FRANC, IT SHOULD BE POSSIBLE TO FINANCE THIS DEFICIT
THROUGH COMBINATION OF CAPITAL INFLOWS ATTRACTED BY CUR-
RENT HIGH MONEY RATES IN FRANCE AND GOVT'S PROGRAM OF
EXTERNAL BORROWINGS, AND THUS TO MAINTAIN FLOATING FRANC
AT REASONABLE LEVEL ON EXCHANGE MARKETS.

(B) 1975 OUTLOOK IS MUDDY. PROJECTED GROWTH RATE
FOR FRENCH ECONOMY IN SAME RANGE AS IN 1974 IMPLIES THAT
IN GENERAL, VOLUME OF IMPORTS WILL BE INCREASING BY
ROUGHLY SAME AMOUNT AS THIS YEAR. GOVT HAS IDENTIFIED
TWO AREAS WHERE IT IS EXPRESSLY SEEKING IMPORT SAVINGS:
OIL FOR SPACE HEATING AND EQUIPMENT GOODS (LESS IN DEMAND
BECAUSE OF POLICY-INDUCED WEAKENING OF INVESTMENT BOOM).
WE WOULD GIVE SOME WEIGHT TO THESE FACTORS, BUT UNDOUBT-
EDLY MUCH LESS THAN DOES FRENCH GAME PLAN. INVISIBLES
WILL ALMOST CERTAINLY DETERIORATE, IF ONLY BECAUSE OF IN-
TEREST COSTS ON LARGE-SCALE EXTERNAL BORROWINGS BEING
UNDERTAKEN TO FINANCE THE DEFICIT. THUS ANY SIGNIFICANT
IMPROVEMENT IN FRENCH CURRENT PAYMENTS POSITION WOULD
HAVE TO COME THROUGH EXPANSION OF EXPORTS. MUCH ATTEN-
TION IN FRANCE HAS FOCUSED ON GAINS TO BE HAD THROUGH
HIGHLY PUBLICIZED DEALS WITH OIL-PRODUCING COUNTRIES AND
SOVIET UNION. HOWEVER, MANY ELEMENTS IN THESE DEALS
HAVE NOT YET JELLED. EVEN TO THE EXTENT THEY REPRESENT
FIRM ORDERS (RATHER THAN JUST POSSIBLE SALES), THERE ARE
DEFINITE LIMITS ON HOW MUCH THEY COULD CONTRIBUTE TO
IMPROVEMENT OF FRENCH TRADE BALANCE IN 1975, BECAUSE OF
LONG LEAD TIMES FOR MANY ITEMS INVOLVED. MAIN THRUST

FOR INCREASED EXPORTS NEXT YEAR WOULD HAVE TO BE TOWARDS GERMANY (WHICH ACCOUNTS FOR ABOUT 20 PERCENT OF FRENCH SALES ABROAD) AND OTHER EC COUNTRIES PLUS SWITZERLAND (ANOTHER 40 PERCENT). CONSEQUENTLY, STATE OF DEMAND IN THESE MARKETS IS CRUCIAL, AND OUR ASSUMPTION IS PARTICULARLY LIMITED OFFICIAL USE

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LARLY THAT THERE WILL BE SOME ECONOMIC RECOVERY IN GERMANY. IN LIGHT OF ABOVE FACTORS, WE PUT 1975 TRADE DEFICIT AT ABOUT \$3.5 BILLION AND CURRENT ACCOUNT DEFICIT AT ABOUT \$5.5 BILLION. THESE FIGURES IMPLY THAT BOTH ACCOUNTS WILL CONTINUE IN THE RED BEYOND END OF 1975.

7. INCIDENCE OF U.S. ECONOMIC OUTLOOK ON PROJECTIONS. - WE DO NOT BELIEVE FRENCH ECONOMIC POSITION, AS DEPICTED BY FOREGOING PROJECTIONS, COULD BE SUBSTANTIALLY IMPROVED BY MOVE ON PART OF U.S. TOWARDS LESS RESTRICTIVE POLICY STANCE. U.S. TAKES LESS THAN 5 PERCENT OF FRENCH EXPORTS. THUS ANY EXPANSION OF FRENCH SALES TO U.S. INDUCED THROUGH MORE BUOYANT BUSINESS CONDITIONS THERE WOULD SCARCELY BE SUFFICIENT EITHER TO MAKE IMPORTANT DENT IN FRENCH EXTERNAL DEFICIT OR TO SWELL SIGNIFICANTLY OVER-ALL FOREIGN DEMAND FOR FRENCH PRODUCTS. OF COURSE, U.S. POLICY SHIFT IN DIRECTION INDICATED MIGHT HAVE GREATER EFFECTS ON ECONOMIC PROSPECTS FOR OTHER, MORE IMPORTANT FRENCH TRADING PARTNERS, AND THESE EFFECTS COULD IN TURN INDUCE SIGNIFICANT MODIFICATION OF FRENCH OUTLOOK.

8. EFFECTS OF POSSIBLE POLICY MODIFICATIONS. -

(A) FOREGOING PROJECTIONS ASSUME MAINTENANCE, IN

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GENERAL, OF STABILIZATION POLICIES NOW IN PLACE: CREDIT SQUEEZE, TIGHT FISCAL POLICY AND, IF NECESSARY, QUANTITATIVE RESTRICTIONS TO HOLD DOWN CONSUMPTION OF ENERGY FOR SPACE HEATING. FRENCH AUTHORITIES APPEAR PREPARED TO ACCEPT SOME SLOWING OF ECONOMIC GROWTH AND A MODERATE RISE IN UNEMPLOYMENT AS NECESSARY, IF UNWELCOME, BY-PRODUCTS OF EFFORTS TO BRING INFLATION UNDER CONTROL. IF, HOWEVER, INDICATORS BEGAN TO SIGNAL SIGNIFICANT ADVERSE TREND OF THESE TWO FACTORS, GOVT WOULD DOUBTLESS MOVE RAPIDLY TO RELAX RESTRICTIVE FISCAL AND MONETARY POLICIES IN EFFORT TO ARREST DETERIORATION. FRENCH OFFICIAL SPOKESMEN HAVE CONSISTENTLY EMPHASIZED NECESSITY TO MAINTAIN GROWTH AT PACE SUFFICIENT TO INSURE HIGH LEVEL OF EMPLOYMENT, AND IN TV ADDRESS EARLIER THIS WEEK PRESIDENT GISCARD D'ESTAING AGAIN ASSURED HIS LISTENERS THAT GOVT WOULD NOT LET ANTI-INFLATIONARY PROGRAM DO "NEEDLESS HARM TO SUBSTANCE OF FRENCH ECONOMY." ANY LIMITED OFFICIAL USE

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RELAXATION OF STABILIZATION POLICIES TO THIS END, BEFORE MIDDLE OR LATTER PART OF NEXT YEAR, WOULD BE LIKELY TO PROVIDE NEW STIMULUS TO PRICE-WAGE SPIRAL IN 1975 AND PROBABLY WOULD LEAD TO A SWELLING OF EXTERNAL DEFICIT. WHILE AUTHORITIES WOULD HAVE SOME POSSIBILITY TO COUNTER LATTER TENDENCY BY ALLOWING EXCHANGE VALUE OF FRANC TO FALL, THEY COULD NOT GO VERY FAR DOWN THIS PATH WITHOUT RISKING ADDITIONAL INFLATIONARY PRESSURE IN FORM OF RISING IMPORT PRICES.

(B) MORE LIKELY PROBLEM FOR GOVT WILL BE WHAT TO DO IF -- AS OUR PROJECTIONS SUGGEST -- STABILIZATION PROGRAM DOES NOT SHOW SIGNS OF PRODUCING RESULTS BEING SOUGHT. WE ARE INCLINED TO VIEW THAT FRENCH AUTHORITIES WILL THINK LONG AND HARD BEFORE PROCEEDING TO ANOTHER TURN OF THE SCREW, IF ONLY BECAUSE OF THEIR CONCERN ABOUT JEOPARDIZING GROWTH AND EMPLOYMENT. SPECTER OF 1968 EVENTS STILL HAUNTS MANY FRENCH POLICYMAKERS, WHO ARE THUS EXCEEDINGLY WARY OF TAKING ECONOMIC MEASURES WHICH THEY THINK COULD SOW THE SEEDS OF CIVIL UNREST. WE SHOULD NOT, HOWEVER, EXCLUDE SOME NEW POLICY INITIATIVES, PERHAPS IN CONNECTION WITH 1975 SPRING SESSION OF PARLIAMENT, TO STRENGTHEN ANTI-INFLATIONARY FORCES BEARING ON MIDDLE AND LATTER PART OF 1975. ASSUMING THAT STEPS TAKEN WERE SIMILAR TO THOSE DECIDED LAST JUNE -- NOTABLY A NEW ONE-SHOT LEVY ON BUSINESS AND INDIVIDUAL TAXPAYERS IN UPPER-BRACKETS -- RESULT SHOULD BE TO DAMPEN SOMEWHAT PROJECTED RATE OF 1975 PRICE INCREASES -- PERHAPS TO UNDER 10 PERCENT -- WHILE CUTTING MARGINALLY INTO GROWTH AND EMPLOYMENT. THERE WOULD PROBABLY BE NO SIGNIFICANT CHANGE IN PROJECTED 1975 EXTERNAL DEFICIT.

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